

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF THE PRESCRIPTION  
DRUG ADDITIONAL BENEFIT  
OFFERED BY  
KAISER FOUNDATION HEALTH PLAN,  
SOUTHERN CALIFORNIA  
IN THE CALENDAR YEAR 2000  
ADJUSTED COMMUNITY RATE  
PROPOSAL**



**JANET REHNQUIST  
Inspector General**

**December 2002  
A-09-02-00077**

# ***Office of Inspector General***

**<http://oig.hhs.gov>**

---

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

## ***Office of Audit Services***

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

## ***Office of Evaluation and Inspections***

The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs.

## ***Office of Investigations***

The OIG's Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties. The OI also oversees state Medicaid fraud control units, which investigate and prosecute fraud and patient abuse in the Medicaid program.

## ***Office of Counsel to the Inspector General***

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

# *Notices*

---

## **THIS REPORT IS AVAILABLE TO THE PUBLIC** at <http://oig.hhs.gov>

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

## **OAS FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.





Region IX  
Office of Audit Services  
50 United Nations Plaza  
Room 171  
San Francisco, CA 94102

December 23, 2002

Report Number: A-09-02-00077

Mr. Richard Cordova, President  
Kaiser Foundation Health Plan  
Walnut Center Executive Offices  
393 E. Walnut Street  
Pasadena, California 91101

Dear Mr. Cordova:

This final report provides the results of our review of the prescription drug additional benefit offered by Kaiser Foundation Health Plan, Southern California (Kaiser), in the Calendar Year (CY) 2000 adjusted community rate proposal (ACRP). During CY 2000, Kaiser provided managed care services under a Medicare+Choice (M+C) contract to Medicare beneficiaries in Southern California.

The objective of our review was to assess whether Kaiser properly valued and reported the prescription drug additional benefit in the CY 2000 ACRP.

Our review found that Kaiser paid less than the Average Manufacturer Price (AMP) for the prescription drugs we reviewed and, therefore, properly valued those drugs. Additionally, we found the prescription drug additional benefit reported in the CY 2000 ACRP was properly based on actual costs.

In written response to our draft report, Kaiser concurred with our conclusions and provided clarification for the background section of the report.

---

## INTRODUCTION

---

### BACKGROUND

The Centers for Medicare and Medicaid Services (CMS) designed the ACRP process to ensure that M+C organizations presented CMS with useful information in a uniform format. The ACRP includes estimates of the funds needed to cover the medical and administrative costs of providing

a package, or plan, of Medicare covered services to any eligible Medicare beneficiary who chooses to enroll in a plan. The ACRP process also includes providing cost estimates of any additional benefits (e.g., prescription drugs and eyeglasses) the M+C organization plans to offer its Medicare enrollees.

An M+C organization must complete a separate ACRP for each coordinated care or private fee-for-service plan offered to Medicare beneficiaries. Through the ACRPs, M+C organizations present to CMS an initial rate that represents the “commercial premium” the organization would charge its non-Medicare enrollees for the same services. This initial rate is adjusted by various factors described in the regulations to establish an appropriate payment rate that reflects the characteristics of the Medicare population. The accuracy of the specific parts of the ACRP is an important administrative tool within the overall framework of CMS ensuring value is received for Medicare funds expended as part of the M+C program. The ACRP also provides a mechanism for the M+C organization to provide additional benefits to Medicare beneficiaries if payments received exceed the properly adjusted commercial rate.

Additional benefits are health care services that are not covered by (1) Medicare or (2) reductions in premiums or cost sharing amounts (coinsurance, co-payments, and deductibles) for Medicare-covered services. The M+C organizations specify the additional benefits and must uniformly offer them to all Medicare beneficiaries under each plan at no additional premium. Those benefits must be at least equal in value to the adjusted excess amount calculated in the ACRP. An excess amount is created when the average payment rate (estimated monthly capitation payment received from CMS) exceeds the adjusted community rate (as reduced by the actuarial value of cost sharing amounts under Parts A and B of Medicare).

During CY 2000, Kaiser provided unlimited coverage of generic and brand-name drugs for members enrolled in its M+C plan. To administer these benefits, Kaiser has developed a medication formulary, which is a list of the preferred generic and brand-name medications available through Kaiser. When prescribed by a physician, the drugs listed in the formulary do not require prior authorization for coverage under the plan. Kaiser owns and operates a pharmacy warehouse, a central refill pharmacy and over 120 outpatient pharmacies in southern California.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

Our review was conducted in accordance with generally accepted government auditing standards. The objective of our review was to assess whether Kaiser properly valued and reported the prescription drug additional benefit in the CY 2000 ACRP.

To accomplish our objective, we reviewed:

- Kaiser’s 1998 base year financial data and the methodology used to develop the prescription drug additional benefit reported in the CY 2000 ACRP, and

- the total actual costs for prescription drugs in CY 2000 and compared these costs with the projected amount for prescription drugs reported in the CY 2000 ACRP.

To determine whether Kaiser properly reported the cost amount for the prescription drug additional benefit, we judgmentally selected a sample of 14 prescription drugs dispensed during December 2000. The sample consisted of the 10 most commonly prescribed generic drugs and the 4 most commonly prescribed brand-name drugs obtained from the “Red Book,” published by Medical Economics Company, which were also contained in Kaiser’s formulary.

For the selected sample items, we:

- verified that the cost for an individual prescription agreed with pricing data provided by Kaiser;
- compared the actual cost reported by Kaiser with AMP data<sup>1</sup> provided by CMS; and
- obtained certification from Kaiser that the costs reported reflected all price discounts, such as rebates, refunds or volume discounts.

We reviewed the financial aspects of the prescription drug additional benefit in the CY 2000 ACRP. Due to the limited nature of our review, we did not conduct a review of Kaiser’s internal controls because it was not necessary to achieve our objectives. We did not audit Kaiser’s CY 2000 ACRP, its financial records, the medical adequacy of the drug benefit, nor whether its utilization and availability to Medicare members was appropriate or adequate.

Our fieldwork was performed during the months of May through August 2002 and included visits to Kaiser’s offices in Oakland and Pasadena, California.

---

---

## RESULTS OF REVIEW

---

---

For the items sampled, Kaiser properly valued and reported the prescription drug additional benefit on its CY 2000 ACRP and based the prescription drug additional benefit line item on actual costs. Kaiser performed an annual inventory for all outpatient pharmacies and adjusted all pricing errors detected during this inventory with adjusting entries in the general ledger to bring the year-end inventory to the actual cost amount. Kaiser officials stated proper drug pricing in the inventory system was a high priority and they continue to implement policies to improve the accuracy of the inventory pricing system.

---

<sup>1</sup> The AMP is the average price received by the manufacturer from their wholesale customers for each drug produced. All drug manufacturers are required to report the AMP to CMS quarterly under the Medicaid drug rebate program.

For each drug and dosage combination reviewed, we compared the total costs of the prescription drugs dispensed at Kaiser outpatient pharmacies during December 2000 to the total cost Kaiser would have paid if it had paid the AMP for the same volume of drugs. Although we determined that some of the sample drug costs were higher and some were lower than AMP, in the aggregate, the total cost of the drugs dispensed by Kaiser was below AMP. Kaiser did not calculate the cost for prescription drugs by individual member since it provided unlimited coverage for generic and brand-name drugs in its M+C plan.

The total projected costs for the prescription drug additional benefit in the CY 2000 ACRP were reasonable compared to the total actual costs Kaiser incurred during the same period. In addition, we obtained certification from Kaiser that the prescription drug additional benefit reported in the CY 2000 ACRP reflected all price discounts, such as rebates, refunds or volume discounts.

### **KAISER'S COMMENTS**

In written response to our draft report, Kaiser concurred with our conclusions and provided clarification regarding the number and locations of their warehouse and refill pharmacies that were discussed in the background section. In addition, Kaiser expressed its belief that the OIG's audit process contained deficiencies because Kaiser was not provided with certain requested documentation pertaining to the review. Kaiser indicated it was not provided: (1) sufficient justification for selecting Kaiser for review, and (2) written documentation of the audit's objectives, scope and methodology. Kaiser stated that such documents are provided as a matter of course when commercial accounting firms conduct audits.

The complete text of Kaiser's comments is included as an appendix to this report.

### **OIG'S RESPONSE**

We appreciate Kaiser's comments regarding facility locations presented in the background section of our draft report. We have incorporated the information into this report.

In letters to Kaiser's counsel and in several discussions with its counsel and M+C officials, we fully explained the objective and scope of our review and provided an outline of the planned methodology. In addition, we explained that we did not provide internal agency documents regarding selection criteria or the audit program in order to protect the integrity of ongoing and future reviews. The OIG considered such documents to be intra-agency documents revealing the agency's deliberative process that were not subject to disclosure.

\* \* \* \* \*

Page 5 – Mr. Cordova

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OIG, OAS reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR part 5.)

To facilitate identification, please refer to report number A-09-02-00077 in all correspondence.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand", with a stylized flourish at the end.

Lori A. Ahlstrand  
Regional Inspector General  
for Audit Services



# APPENDIX

Kaiser Foundation Health Plan, Inc.  
Walnut Center  
Pasadena, California 91188



November 7, 2002

Lori A. Ahlstrand  
Regional Inspector General for Audit Services  
Office of Inspector General  
Region IX, Office of Audit Services  
50 United Nations Plaza  
Room 171  
San Francisco, CA 94102

Common Identification Number A-09-02-00077

Dear Ms. Ahlstrand,

Thank you for your letter of October 8, 2002, enclosing your draft report of the results of your review of the prescription drug benefit that Kaiser Foundation Health Plan, Inc. (Southern California) included in its CY 2000 Adjusted Community Rate proposal (ACRP). We are pleased that your report reached conclusions that confirmed what Kaiser has long believed, i.e., that "the total projected costs for the prescription drug additional benefit in the CY 2000 ACRP were reasonable compared to the total actual costs Kaiser incurred during the same period." As our personnel told yours during the audit, accurate tracking of prescription drug inventory and accurate pricing of prescription drugs is a high priority for Kaiser Permanente, and we continue to try to improve our policies and procedures in this regard.

Although we are pleased with the draft report's conclusions, we believe the OIG's audit process itself has some deficiencies. We asked OIG personnel why Kaiser Permanente was selected for this audit, and asked for audit selection criteria. The only answers we received about why Kaiser Permanente was selected were that (1) the OIG personnel had some familiarity with Kaiser Permanente because they had recently audited our ACRPs (at CMS' request) and (2) OIG happened to have an auditor in the area who was available to do the audit. We questioned these factors as justifying the selection of Kaiser Permanente as an audit target, especially in the absence of any specific selection criteria. We were also unsuccessful when we requested written documentation of the objectives of the audit, the scope of the audit, and the audit methodology. We never received these, although we understand such items are provided as a matter of course when commercial accounting firms conduct audits. Because we never received these documents, we could not, for example, compare how the protocol said the audit would be conducted against how the OIG auditors were actually conducting the audit. We believe the OIG should provide its audit targets with reasonably requested information about its audit process.

In addition, there are a few minor factual discrepancies in the draft report. It says that "Kaiser owns and operates over 120 outpatient pharmacies in Southern California, two pharmacy warehouses and a central refill pharmacy where drug prescription in California are refilled." In fact, Kaiser Permanente operates only one pharmacy warehouse in Southern California (in Downey). (It also operates two pharmacy warehouses in Northern California - one each in Oakland and Livermore). Also, the central refill pharmacy does not refill all Kaiser Permanente prescriptions in California. There is a separate refill pharmacy in Northern California. The Southern California refill pharmacy refills about 35% of the prescriptions originally filled at Kaiser Permanente pharmacies in Southern California, which is about the same percentage as its Northern California counterpart refills for prescriptions originally filled at Kaiser Permanente pharmacies in Northern California.

Thank you for the opportunity to comment on the draft report. If you have any questions, you may call Judith Mears, a Kaiser Permanente attorney, at 510 271-5964.

Very Truly Yours,

A handwritten signature in black ink, appearing to read "R. Cordova", with a stylized flourish at the end.

Richard Cordova  
President, Southern California Region  
Kaiser Foundation Health Plan, Inc.  
Walnut Center  
393 E. Walnut Street  
Pasadena, CA 91101